Insurance for Law Firms

What You Need to Know for 2014

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How best to allocate insurance dollars is a perennial issue that lawyers need to address. Following are seven recommendations in connection with malpractice insurance (along with a three "bonus" observations on employment practices liability [EPL], cyber, and directors and officers liability insurance [D&O]), which will hopefully help you be a savvier buyer at your next renewal.

Seven Recommendations

1 It is cheap (relatively speaking)

Since the premium spike in the liability insurance market in 2002–2003, rates for lawyers' professional liability insurance have steadily declined over the past ten years. Premium levels have stabilized over the past eighteen months, which indicates that we *may* be seeing a floor in pricing, but competition continues to be fierce—there are approximately forty-five insurance companies currently writing malpractice insurance for lawyers in California.

2 It is not a commodity

Many of the forty-five malpractice insurers compete solely on price. Some of the policies being placed are very inexpensive but offer very limited coverage in the event of a claim. When purchasing insurance, the goal should not just be to pay as little as possible but rather to ensure that the cost of a potentially catastrophic risk has been transferred to a responsible, financially strong insurer, who will step up and cover a claim if and when one is made (in exchange for a reasonable premium).

Paying attention to policy wording is important, and so is determining up front who, exactly, will be administering

and defending a claim. The best insurers have experienced in-house claim professionals on staff who work hard to partner with their insureds in the joint defense of claims. Moreover, there is a "top tier" of law firms that specialize in defending legal malpractice allegations—you want to be sure that several of them are on your insurer's "panel" for engagement in the event of a claim.

3 Risk management matters

More than ever, insurers are asking if their law firm insureds have robust loss-prevention protocols in place. Starting with diligent client intake, and ending with uniform use of nonengagement or disengagement letters, there is growing recognition that firms that implement law practice management best practices throughout the life cycle of client engagements encounter fewer and less severe claims (and pay lower malpractice premiums accordingly). There is much low-hanging fruit in this sphere—even the simple step of putting in place a risk management manual can pay dividends.

4 Claims happen — even to the best

Time and again we hear from law firms that "we do a great job, have great systems, and don't make mistakes—there's no way *we* are going to be sued. Malpractice insurance is a big scam." Unfortunately, this is just not the case. Even if the legal representation is flawless, if there is a "bad" result (as there often is for one side or the other in most matters) an unhappy client will at least contemplate making a claim. Even frivolous allegations of malpractice can cost significant amounts of money and time to defend.

5 If you don't have it, you have to disclose

The State Bar of California Rule of Professional Conduct 3-410 requires that if an attorney's representation will exceed four hours, and the attorney does not have malpractice insurance, the client must be so informed, in writing. (The converse is no longer true—attorneys do not have to disclose that they do have malpractice insurance in place. This is a clause in some engagement agreements that have not been updated in several years).

6 Professional corporations and limited liability partnerships have minimum limit requirements

Firms organized as professional corporations (PCs) or limited liability partnerships (LLPs) are subject to rules that require them to have minimum limits of liability in place. For LLPs, Corporation Code Section 16956(2)(A) applies (minimum aggregate limit of $1 million for firms with five attorneys or fewer, with an additional $100,000 required for every additional attorney). PCs are governed by the State Bar of California's Rule 3.158(A)(1)(c), which requires limits of $50,000 per claim or an aggregate of $100,000 times the number of attorneys (subject to maximums of $500,000 per claim and $5,000,000 aggregate).

Compliance with both of these requirements is enforced by annual declarations under penalty of perjury—lawyers need to ensure that they are not jeopardizing their firm's status by making inadvertently false declarations through failure to have required limits in place.

7 Claims adjustors and defense counsel are the new underwriters

Insurance companies have come to realize that no one has a better opportunity to evaluate a law firm than claim adjustors and defense counsel. In addition to all of the standard reasons law firms should cooperate and be professional in the event of a claim, firms need to realize that they are being "reunderwritten" at this juncture. Attorneys' conduct not only has ramifications for the claim—interactions with claim professionals can significantly affect future insurability.

Three Bonus Observations

1 Law firms are not a favored class for employment practices liability

Insurance for wrongful termination and harassment claims in California continues to become more expensive, and the coverage can be particularly difficult to place at reasonable premium and deductible levels for law firms. While the reasons are likely many and varied, the bottom line is that insurers' loss histories show that law firms are workplaces that generate more than their fair share of expensive employment claims. While this coverage is certainly recommended for law firms with a critical mass of employees, it is not inexpensive (and many of the "bells and whistles" available in the past, such as coverage for wage and hour claims, have become very difficult to obtain).

2 Cyber liability insurance is gaining traction

The exposure from cyber claims continues to grow. As one cynic recently averred, "It's not *if* you're going to get hacked, it's *when* you're going to get hacked." As keepers of sensitive information, law firms of all sizes are increasingly tempting cyber targets. While malpractice insurance may address some potential claims in this arena (by clients who have been damaged by a security breach), only cyber liability insurance can address other "direct" or "first-party" claims that arise from a hacking event, such as:

- Costs of retaining an expert to get a firm's systems up and running
- Business interruption loss (lost billings due to a system being down)
- Dealing with "ransom" demands (pay us X dollars and we'll unfreeze your systems)

Many insurance industry experts believe that law firms are on the cusp of a wave of losses in this area, given the lack of robust security at many firms.

3 For larger firms, management liability (private company D&O) is becoming standard

Claims against members of a law firm's management committee, while infrequent, can be devastating. Allegations such as breach of fiduciary duty or breach of the partnership agreement are invariably time-consuming and expensive. As seen in several of the recent high-profile law firm dissolutions, fingers of blame invariably get pointed at the decision makers. D&O insurance can greatly ameliorate these claims, which typically involve high-running emotions and high-dollar allegations.

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